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INDEPENDENT GUARANTEES AND STAND-BY LETTERS OF CREDIT

Proposal of the United States of America

Note by the Secretariat

1. At the seventeenth session of the Working Group the delegation of the United States of America expressed the concern that the draft text disregarded the existing difference in terms of firmness between stand-by letters of credit and European-style bank guarantees and that it might be inappropriate to aim for a unitary set of rules that would do justice to neither type of undertakings, for both of which there was a demand on the market. It therefore suggested to envisage some separate provisions that applied only to firm undertakings, whether or not labelled in the uniform law as stand-by letters of credit, and promised for that purpose, to provide the Secretariat with a list of such provisions and relevant information. It was stated in reply that the degree of firmness was not a valid criterion to distinguish between stand-by letters of credit and bank guarantees as such; differences in firmness existed within each of these two categories that were developed separately for historical reasons. It was also recalled that, during a similar discussion, suggestions had been made for taking into account practical differences of undertakings according to their purpose and payment conditions and, above all, that it had been agreed to continue with the effort of formulating rules of general application. (A/CN.9/361, paras. 148-149).

2. Following the above suggestion, the Secretariat received from the United States delegation a set of annotated draft rules for a separate chapter dealing exclusively with stand-by letters of credit, based on the assumption that another chapter would deal exclusively with independent guarantees. The draft rules proposed by the United States are set forth in the Annex to this note.

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3. While the revised draft prepared by the Secretariat (A/CN.9/WG.II/WP.76 and Add. 1) follows the above recalled agreement "to continue with the effort of formulating rules of general application" and takes into account specific features of stand-by letters of credit, for example, by incorporating into many provisions elements that are of practical relevance only to stand-by letters of credit, it was thought advisable to bring the United States proposal to the attention of delegates in advance of the next session. Such information is expected to facilitate the decision on the crucial question of the treatment of stand-by letters of credit in the future Convention. It should also help delegates particularly those from other countries where stand-by letters of credit are frequently used to examine the rules proposed by the United States as to whether they reflect the current practice in their countries and whether they conform to what should be the rules of universal application for the years to come.

Annex

Proposal of the United States of America: draft rules on stand-by letters of credit [N1]

CHAPTER I. INDEPENDENT UNDERTAKINGS [N2]

Article 1. Substantive Scope of Application of Convention [N3]

This Convention applies to international independent undertakings in the form of independent guarantees and standby letters of credit. [N4]

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1. In response to paragraph 148 of UNCITRAL Document A/CN.9/361 (27 April 1992) as to the possible need for separate provisions that would apply only to firm undertakings (whether or not some or all standbys are firmer than some or all bank guarantees) and to the comment of the European Banking Federation and others at the UNCITRAL Working Group's XVIIth Session that there were insufficient specific references to standby practices in the UNCITRAL working papers, the United States Department of State, Office of the Legal Advisor on Private International Law, appointed a Select Advisory Group of experts in standby letter of credit law and practice to develop this draft for submission to the Secretariat. The Select Advisory Group members, which included two members of the United States delegation, two bank operation managers specialized in letter of credit issuance, and a private attorney also specialized in this field, are:

James G. Barnes, Baker & McKenzie, Chicago, IL
Alan Bloodgood, Morgan Guaranty Trust Co., New York, NY
James E. Byrne, George Mason School of Law, Arlington, VA
Boris Kozolchyk, University of Arizona College of Law, Tucson, AZ
Vincent Maulella, Chemical Bank, New York, NY

2. This draft focuses on standby letters of credit insofar as the law applicable to them differs from the law applicable to independent guarantees. Therefore, this draft focuses on the changes to be made in the current UNCITRAL draft in order to treat standbys appropriately. (The current UNCITRAL draft is set forth in UNCITRAL Working Paper 73, entitled Independent Guarantees and Standby Letters of Credit; Tentative Draft of a "Uniform Law on International Guaranty Letters", A/CN.9/WG.II/WP.73, dated 17 Sept. 1991 and A/CN.9/WG.II/WP.73/Add.1, dated 14 Oct. 1991, as modified by the Working Group as reported in Document A/CN.9/358, dated 12 Feb. 1992 and A/CN.9/361 dated 27 April 1992.)

For purposes of organization, it is assumed that the first chapter of the next UNCITRAL draft will deal with common elements, the second chapter with independent guarantees and the third with standbys. Otherwise, this draft follows the format, language and tentative conclusions of the UNCITRAL Working Group's current draft and working papers.

3. This draft assumes that the next UNCITRAL draft will be cast in the form of a convention rather than a model law (see paragraph 147 of A/CN.9/361). Should the working Group decide otherwise, this draft could be easily adapted to a model law format.

4. The term "independent undertakings" is substituted for "guaranty letters" because it more clearly includes both guarantees and letters of credit, and it is better balanced than "guaranty letter" (or any other term which includes the word "guarantee"). The expression "independent undertakings to honor documentary demands for payment" should also be considered as a substitute term.

CHAPTER 2. INDEPENDENT GUARANTEES

[See UNCITRAL Draft]

CHAPTER 3. STANDBY LETTERS OF CREDIT [N1]

Article 1. Standby Letters of Credit

This Chapter applies to standby letters of credit ("standbys").

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1. It is uncertain whether this chapter should include rules of interpretation in the event of any conflict with the rules in Chapter 1 and 2. This approach was not taken here on the assumption that Chapter 1 will be drafted to include only those legal principles that are common for independent guarantees and standbys and will thereby avoid conflicts with Chapter 3 and that it will be self-evident from the scope of Chapter 2 that its rules do not apply to standbys.

Article 2. Definition of Standby Letter of Credit

(1) A standby letter of credit is an independent undertaking given by one or more banks or other institutions [or persons] ("issuer") to honor presentations by another person or persons ("beneficiary") [for the benefit of such person(s) or others] [N1] for a certain or determinable amount of a specified currency or unit of account or other item of value [N2] or to accept a bill of exchange or draft for a specified amount or to incur a deferred payment obligation [N3] in conformity with the terms and documentary [N4] conditions of the undertaking upon presentation of stipulated documents. [N5]

(2) The undertaking may be given

(a) at the request of the customer ("applicant")[N6] of the issuer; or

(b) on the instruction of another bank, institution or person acting at the request of the applicant of that instructing party ("instructing party"); or

(c) on behalf of the issuer itself.[N7]

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1. The term "another person" in the definition of "beneficiary" might not adequately accommodate standby letters of credit issued by the issuer to itself acting as a trustee for another or acting through another branch. For this reason, the term has been broadly defined in Article 6.

2. The brackets surrounding the language, "[or other item of value]" introduced in the UNCITRAL draft are removed in view of the fact that standbys sometimes provide for honor by delivery of e.g., gold or units of stock or other securities. Although this practice is not widespread, there is no theoretical reason to preclude it. In order to leave an opening for future development should the market so dictate, the brackets have been removed.

3. The UNCITRAL draft language "[or to accept or negotiate without recourse a bill of exchange for a specified amount]" is retained without brackets with respect to standby letters of credit for the reasons stated in Paragraph 35 of document A/CN.9/358 (12 Feb. 1992). Although this practice is not widespread, there is no theoretical reason to preclude it. Consequently, it is thought prudent not to foreclose this option.

4. Standby letter of credit law and practice are exclusively documentary. Indeed, the independence of standbys is derived from and defined by their exclusively documentary character. The reference in the UNCITRAL draft to "essentially documentary" is unacceptable to the extent it calls into question the exclusively documentary character of the standby. This draft refers to the documentary character of standbys in ways that are compatible with the latest draft revision (ICC 500) of the Uniform Customs and Practice (UCP).

5. The Working Group has not determined the extent to which it may be appropriate to address commercial letters of credit. Should it decide to exclude commercial letters of credit, then the definition of standby (and of independent guarantee) may need further qualification in order to distinguish one from the other. See note 2 to Article 6 of this draft.

6. UNCITRAL Draft Article 2 uses the terms "gurantor" and "principal" as the titles of the parties to the undertaking. These terms are peculiar to guarantee practice and are not appropriate for standby letters of credit. The terms "issuer" and "applicant" are appropriate to standbys and reflect the terminology used in the UCP.

7. This draft chooses neither Variant X nor Y of UNCITRAL Draft Article 2 because the discrete examples and situations addressed in those variants might have regulatory significance but would have no commercial law effect on standby letters of credit. See the definitions of various types of standbys in Article 6 of this draft.

Article 3. Independence of Standby

(1) An undertaking issued by a bank or other financial institution [or other person who regularly issues such undertakings] is irrebuttably deemed to be independent [N1] if it contains the heading "Standby Letter of Credit" or "Letter of Credit", is stated to be subject to international rules of letter of credit practice [N2], or undertakes to honor solely upon presentation of stipulated documents [N3].

(2) An undertaking is independent in that the issuer's performance to the beneficiary is not subject to or qualified by the existence or validity of an underlying transaction or of any terms other than those appearing in the undertaking or any condition, act or event other than presentation of stipulated documents. [N4].

(3) If a standby credit contains condition(s) without stating the document(s) to be presented in compliance therewith such condition(s) shall be deemed as not stated and shall be disregarded. [N5]

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1. The use of an irrebuttable presumption based upon a formal heading in UNCITRAL Draft Article 3(2)(a) is accepted and expanded. For letters of credit, however, the names "Independent Guaranty Letter", "Independent Documentary Promise", or "First Demand Guaranty Letter" suggested in the UNCITRAL draft would be inappropriate and, so, the terms "Letter of Credit" or "Standby Letter of Credit" are used to reflect standby law and practice.

2. Incorporation of internationally recognized rules of letter of credit practice in an undertaking also clearly signals that the undertaking is intended to be a standby letter of credit.

3. Should it be determined that the rules set out in this draft Chapter 3 for a firm, payment oriented undertaking apply to certain types of guarantees as well as to standbys, a method of identifying and distinguishing these guarantees may be needed here and/or in the definitions provided in Chapters 1 and 2.

4. The use of recitals of independence in UNCITRAL Draft Article 3 is not followed in the Select Advisory Group's draft because standby independence is a consequence of the determination that the undertaking is a standby letter of credit based on formal criteria rather than recitals that the undertaking is independent. Accordingly, this draft Article 3 of Chapter 3 sets forth the meaning of independence and its inextricable linkage with its documentary character, as well as the formal requirements by which an undertaking will irrebuttably be deemed a standby letter of credit.

5. Because the independence of a standy letter of credit is irretrievably linked to its documentary character, the substance of Article 13(c) of the Uniform Customs and Practice for Documentary Credits No. 500 is incorporated at this point in the standby rules.

Article 4. Internationality of the Standby Letter of Credit [N1]

(1) A standby letter of credit is international if:

(a) The places of business specified in the standby letter of credit of any two of the following parties are in different States: issuer, beneficiary, applicant [instructing party], adviser or confirmer [N2] or

(b) The standby letter of credit states that it is "international" or that it is subject to this Convention or to international rules of letter of credit practice [N3]

(2) For the purposes of paragraph (1) (a), if it appears in the standby letter of credit that a party has more than one place of business, its place of business is that which has the closest relationship to the standby letter of credit. [N4]

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1. These draft rules for standby letters of credit reflect variant A or Article 4 of the UNCITRAL draft which was preferred by the Working Group.

2. This draft adds "adviser" and deletes the brackets surrounding "confirming bank" in the UNCITRAL draft to reflect the assumption in standby practice that the place of business of an adviser and a confirmer would be relevant in determining the internationality of a standby letter of credit.

3. UNCITRAL draft Article 4 is expanded to include those standbys which are issued subject to international rules of letter of credit practice, because under current law and practice in most jurisdictions the simplest and surest way to make an undertaking enforceable as a standby letter of credit is to make it subject to and within the scope of the UCP.

4. Article 4(2) of this draft discourages the use of contacts not apparent from the face of the standby and therefore deletes UNCITRAL Draft Article (2)(b) and clarifies UNCITRAL Draft Article (2)(a) to refer only to a standby which itself shows more than one place of business for a party.

Article 5. Interpretation of this Convention

[There is no need for specific provisions for standbys; UNCITRAL draft Article 5 is acceptable as the general rule.]

Article 6. Definitions and Rules of Interpretation

For the purposes of this Convention unless otherwise indicated in a provision of this Convention or required by the context:

(1) "Document" includes any paper, draft, demand, promise, instrument, or representation of fact or of law, whether in writing or in any manner generally used in letter of credit practice. [N1]

(2) "Standby letter of credit" is defined in Article 2. Standby letters of credit are governed by the same principles and rules that govern all letters of credit without regard to differences in their purpose or function. [N2] In so far as they serve different purposes of the applicant and beneficiary, they may be identified and categorized to include the following types of standbys:

(a) A financial standby, which provides for honor upon presentation of documents stating that payment is due for money borrowed or advanced, or on account of any mature indebtedness undertaken by the applicant or another person.

(b) A performance standby, which provides for honor upon presentation of documents stating that payment is due because of a default in the performance of a nonfinancial or commercial obligation.

(c) An advance payment standby, which provides for honor upon presentation of documents stating that an advance payment has been made and that its return is demanded.

(d) A bid standby, which provides for honor upon presentation of documents stating that there has been a failure to tender a bid and/or to execute the award on the bid.

(e) A commercial standby, which provides for honor upon presentation of documents stating that there has been a failure to deliver or to pay for delivery of goods or services under an underlying commercial transaction, supported or not by a commercial letter of credit.

(f) A clean standby, which provides for honor solely upon the presentation of drafts or demands for payment.

(g) A counter standby, which provides for honor upon presentation of documents stating that the beneficiary has honored or is obligated to honor its standby or commercial letter of credit, guarantee or other undertaking.

(3) "Issuer" includes one or more banks or other institutions [or persons] acting severally or otherwise, and identified as issuer(s) in a standby letter of credit and may include one or more agent(s) acting for some or all issuers in the issuance, amendment, honor or dishonor or any other identified action to be taken relative to the credit. [N3]

(4) "Beneficiary" includes one or more persons identified as beneficiary(ies) and may include one or more of them acting in their own right or as agent for some or all of them in making demands for honor or transfer, consenting to cancellation or amendment or taking any other action that may be taken by a beneficiary of a letter of credit.

(5) "Confirmer" is a person authorized by the issuer to add its independent undertaking to honor to that of the issuer. Unless expressly stated otherwise, the confirmer's undertaking is to honor conforming presentations to the confirmer, and the issuer's authorization obligates the issuer to reimburse the confirmer upon such honor. [N4]

(6) "Person" includes as "another person" one acting also as a fiduciary or through a branch in another jurisdiction. [N5]

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1. In order to avoid confusion resulting from the historical distinction between documents, on the one hand, and drafts and demands, on the other hand, this draft includes a definition of the term "document" which makes it clear that drafts and demands are included in the term "document". It also expressly avoids the connotation that the term is paper-based.

2. The catalogue of standbys is given here for illustrative purposes. All standbys, as well as commercial letters of credit, are governed by the same legal principles without regard to function or purpose. The differences relate to the types of documents to be presented, the value of those documents (to the applicant or as collateral for others) and whether and how a particular undertaking will be regulated, e.g., under risk based capital adequacy guidelines for international banks.

3. Large standby letter of credit arrangements are frequently syndicated in a form in which all credit providers act as issuers, severally liable for their respective percentage interests in the arrangements but represented by a single bank through which presentation and payment are effected.

4. A purported confirmation that is not authorized by the issuer may be enforceable as a separate letter of credit by the purported confirmer issued on its own behalf, but it is not a confirmation.

5. The phrase "another person or persons" is broadly defined for the reason stated in Note 1 Article 2 of this draft.

Article 7. Format and Establishment of the Standby Letter of Credit [N1]

A standby letter of credit may be issued in any form which preserves a complete record of the information contained therein and is authenticated [N2] as to its source by means generally accepted in international letter of credit practice or by procedures agreed upon by the parties. [N3] A standby letter of credit becomes effective and irrevocable when it is issued. [N4]

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1. This draft reflects Variant B of the UNCITRAL draft Article 7, which was preferred by the Working Group.

2. Authentication may be by means of comparing signatures or by the use of test keys or algorithms or other commercially acceptable means.

3. The brackets in Variant B of UNCITRAL draft Article 7 are deleted because authentication is necessary for purposes of electronic transmission of standby letters of credit.

4. In accordance with the decision of the Working Group at its XVIth session, Variant Y of UNCITRAL draft Article 7 was followed with the introductory clause deleted.

Article 8. Amendment

Unless otherwise provided in the credit [N1], a standby once established [as irrevocable [[N2]] cannot be canceled or amended without the agreement of the issuer, the confirmer (if any) as to its confirmation [N3] and the beneficiary, and no cancellation or amendment proposed by the issuer is effective against the beneficiary until the beneficiary communicates its consent [N4].

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1. This clause signals that a letter of credit may effectively provide for increase, extension or other amendment or for cancellation upon the issuer's unilateral act or failure to act, including the issuer's mere sending of a notice or receipt of a document from the beneficiary or applicant.

2. Irrevocability need not be mentioned here if the prior article on establishment makes standbys irrevocable where silent on the point.

3. A confirmer's consent is required before an amendment proposed by the issuer affects the confirmation. If the confirmer withholds consent, the amendment is nonetheless effective as to the issuer.

4. The requirement for express consent is derived from Article 9e of draft UCP 500.

Article 9A. Transfer of Rights [N1]

(1) A standby letter of credit must be designated as transferable in order to transfer the beneficiary's right to demand honor. The beneficiary's right to make a demand for honor may not be transferred except to the extent and in the manner authorized in the standby letter of credit. [N2]

(2) If the credit is transferable, but does not specify the extent or manner of the transfer [N3],

(a) partial transfers are prohibited unless permitted,

(b) successive transfers are prohibited unless permitted, and

(c) the issuer or other person authorized in the credit to effect transfer may impose reasonable conditions to avoid increased risk [N4]

(3) An issuer must, and any other authorized person may, effect transfer in accordance with the transfer conditions applicable to the credit. The transfer of the right to demand honor affects the name of the beneficiary and such other terms and conditions of the credit, if any, as are specified in the transfer provisions of the credit. [N5]

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1. For greater clarity, this draft has put into separate articles the topics of transfer of drawing rights and assignment of proceeds of honor.

2. Because standbys are regularly issued as transferable, the alternative represented in UNCITRAL draft Article 9(1) Variant B is not appropriate. Because standbys are enforceable on the basis of mere representations, frequently on the basis of the beneficiary's own representations of fact or conclusions that a default has occurred, they are presumed to be non-transferable, and any permission for transfer in the credit is to be strictly construed.

3. Transferable standbys frequently provide for a precise form of transfer demand to be presented to the issuer and specify, e.g. that partial transfers are prohibited but that successive transfers are permitted, that the transferor and/or transferee must certify that the underlying contract or fiduciary relationship or other underlying transaction has been duly transferred, and that the transferee supplants the transferor for all purposes after the effective date of transfer, plus other terms intended to protect the issuer and/or applicant.

There remain instances in which the standby states merely that it is "transferable" or is addressed to a named beneficiary "and successor or assigns" or is deemed transferable by operation of law that overrides letter of credit presumptions and policies of nontransferability and strict enforcement (see comment 5 below). In such instances, this Article supplies appropriate norms for standbys, including the right to impose reasonable conditions such as presentation of the standby with a written request for an

irrevocable transfer signed by the beneficiary and transferee, payment of customary fees, and certifying as to compliance with all applicable laws and regulations. These norms are necessary because the UCP transfer articles are typically excluded from standby transfer provisions because they are designed solely to facilitate transfer in the context of a commercial letter of credit issued to a seller for transfer in part to the seller's supplier.

4. This provision analogizes a transfer to an amendment of the credit. By transferring the credit, the name of the named beneficiary is changed but, absent additional amendments pursuant to Article 8, including comment 1 to Article 8, nothing else in the credit changes. Accordingly, the transferee beneficiary signs all demands and other documents that may be signed by the beneficiary but must obtain third party documents or signatures if any are specified in the credit.

5. This draft does not deal expressly with the enforcement of standbys by persons claiming to have succeeded to the beneficiary's rights by operation of law. Increasingly, transfers by operation of law are expressly addressed in standbys because this aspect of the form of many standbys is dictated by government agencies that regulate the beneficiaries to whom the standbys are issued. In those instances in which the letter of credit policy of strict construction against transfer has conflicted with the policies favoring the protection of the beneficiary's creditors and other constituencies, the courts have sometimes permitted the latter to override the former. Because this is largely a matter of balancing letter of credit law and policy against other public policies, it may be prudent to treat this issue by way of comment mentioning these non letter of credit policies in favor of certain successors by operation of law and the desirability of never overriding an issuer's right to decline to effect a transfer that is not accomapnied by a signed written demand with appropriate documentation establishing that succession by operation of law has in fact occurred under applicable law.

Article 9B. Assignment of Proceeds [N1]

(1) The beneficiary may assign to another person any proceeds to which it may be entitled under a standby letter of credit. An assignment of the proceeds of the credit becomes effective against the issuer or any other person effecting payment of proceeds upon notice from the beneficiary of the assignment and written approval of the notified assignment signed by the issuer or other person effecting payment of the proceeds.

(2) The rights of an assignee of proceeds do not include the right to demand honor under the standby letter of credit, do not exceed the rights of the beneficiary to receive such proceeds, and, unless otherwise specified in the approval of the assignment, are subject to the rights of the payee or endorsee, if different from the beneficiary, of any draft drawn under the credit and subject to set off rights of the issuer or other person effecting payment of the proceeds.

(3) The issuer or other person requested to approve an assignment of proceeds may impose reasonable conditions to avoid increased risk. An approval is effective only against the issuer or other person signing it.

(4) An issuer or other person effecting payment of the proceeds who pays the proceeds to the beneficiary and/or the assignee(s) in accordance with the terms of the letter of credit, its assignment approval(s) and this Article shall be discharged from its obligations to all interested persons including third parties.

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1. Most banks use assignment of proceeds forms signed by the beneficiary and the issuer (or other paying or negotiating bank) for both commercial and standby letters of credit for the purposes of clarifying and protecting the expectations of all concerned. This approval procedure is fairly simple in the case of a straight standby payable against the beneficiary's demand, but can become quite complicated if the credit permits drafts to be drawn for negotiation or payment by a bank other than the issuer. Because of the possible complexity and because the UCP does not supply relevant norms, this draft Article provides a framework for protecting the parties against unauthorized or conflicting irrevocable assignments. In this regard, reasonable conditions that may be imposed would include presentation of the standby with the beneficiary's signed written request for an irrevocable assignment of proceeds and certifying as to compliance with all laws, payment of customary fees, and certifying as to no prior or subsequent transfer of rights, assignment of proceeds, or drawing or endorsement of any draft that would conflict with the requested assignment.

Article 10. Termination

(1) A standby letter of credit terminates [N1] irrespective of whether any document embodying it is surrendered when:

(a) the issuer receives from the beneficiary a statement of release from liability in any form referred to in paragraph 1 of Article 7; or

(b) the validity period of the standby letter of credit expires in accordance with Article 11. [N2]

Termination does not affect rights or obligations previously acquired by compliance with the terms and conditions of the standby letter of credit.

(2) That the amount available under a standby may have been reduced to zero does not terminate it if it provides for automatic reinstatements or other automatic increases of the amounts available. [N3]

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1. The language in UNCITRAL draft Article 10 "ceases to be effective" and the phrase "Cessation of effectiveness" in the title to Article 10 are inappropriate for standbys because they introduce an artificial and commercially undesirable distinction between the existence and the effectiveness of a letter of credit.

2. Although language appropriate to standbys is introduced, the provisions in UNCITRAL draft Article 10 (a) and (b) are retained.

3. This draft adds a subparagraph (2) to Article 10 to take into account standby letters of credit that are "revolving" or otherwise provide for automatic reinstatement of the amount available after a drawing has been honored. There is an established "reinstatement" practice for direct pay financial standbys that secure long term debt obligations. These standbys provide for automatic reinstatement of the amount honored within, e.g., 10 days after honor of a drawing of an amount equal to a periodic interest payment due on the debt obligation that underlies the credit. See paragraph 127 of Document A/CN.9/358 regarding the inappropriateness of draft Article 10 (c) with regard to standbys.

Article 11. Expiry

(1) The validity period of a standby letter of credit expires at the expiry date, which may be a specified calendar date or the last day of a fixed period of time stipulated in the standby. [N1]

(2) If the standby letter of credit does not state an expiry date, the validity period expires [one(1)] year [N2] after the establishment of the standby letter of credit, unless amended in accordance with Article 8 to state an expiry date. [N3].

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1. UNCITRAL Draft Article 11 (1) (b) contradicts standby law and practice which requires that an expiration event be documentary. Document A/CN.9/358, Paragraph 144 refers to "a significant degree of use, in guarantees as well as in stand-by letters of credit, of expiry-event clauses that did not specify the presentation of a particular document." Non-documentary conditions in standby letters of credit are unacceptable whether for purposes of demanding payment or determining whether the credit is in force.

2. The issuance of a standby with no stated expiration date is an aberrant practice which should not be endorsed by a long presumed validity period.

3. UNCITRAL draft Article 11 (2) contains a reference to an agreement by the parties to an extension of the validity period. Under standby practice, such an agreement, if not expressed in the credit, can only take the form of an amendment. See draft Article 8 and Note 1 thereto.

Article 12. Determination of Rights and Liabilities

Subject to the provisions of this Convention, the rights and obligations of the parties under a standby letter of credit are determined by the terms ad conditions [N1] set forth in the standby letter of credit and any rules, [general] conditions or international usages, such as international rules of letter of credit practice, to which it is subject. [N2]

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1. The bracketed language of the UNCITRAL draft Article 12 "and conditions" is retained without the brackets since it is necessary to refer to terms and conditions with respect to standbys.

2. The reference in the UNCITRAL draft to "rules, [general] conditions or usages referred to therein" is vital to standby practice and is given further emphasis in this draft by express reference to international rules of letter of credit practice to which standbys are commonly made subject.

Article 13. Liability of Issuer

(1) The issuer, and any confirmer, shall act in good faith and exercise reasonable care as required by standard banking practice as provided below. The applicant may agree that examination of some or all of the documents under some or all circumstances is not required or that the examination be carried out within a very short period of time and subject to a lesser duty of care. The examiner's duty of reasonable care owed to the beneficiary shall be satisfied upon honor or justifiable dishonor of a demand in accordance with the standards set forth in Article 16. Examiners may also be exempted [generally] from [grossly] [negligent conduct] but not from their failure to act in good faith or for any [grossly negligent conduct] [act or omission done either with the intent to cause damage or recklessly and with the knowledge that damage would probably result]. [N1]

(2) Nothing herein precludes an issuer, confirmer, or other examiner from recovering from an applicant or beneficiary for mistaken or undue payment under principles of unjust enrichment or from limiting recovery against it to the amount available under the credit. N2]

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1. The Select Advisory Group here retained the basic approach and text of the UNCITRAL draft with some elaboration on the parties' freedom of contract, including the right, e.g., for reduced examination fees, to reduce or eliminate the usual examination that an applicant expects from its issuer. Although premature at this stage, it may be that this and related Articles will need to be made more precise in order to guard against confusion as to whether and under what circumstances one party owes a duty to another that is not expressed in the party's credit, confirmation, advice or other writing or in written international rules of letters of credit practice. Similarly, it may be desirable to provide examples as to what consitutes bad faith conduct by an issuer (e.g., dishonor pursuant to prior agreement with the applicant to dishonor arbitrarily and without regard to the existence of any defense) if such examples are to be provided in the case of fraudulent conduct by the beneficiary (e.g., presentation of a demand arbitrarily and without regard to the existence of any basis for making the demand).

2. This Convention will not cover all of the legal relations between the various parties, a point which the Select Advisory Group determined should be made express here (and/or in Article 12).

Article 14. Demand for Payment

[There is no need for specific provisions for standbys if the term "payment" is broadly defined or the term "honor" is substituted for it. See Notes 2 and 3 to Article 2 of this draft.]

Article 15. Notice of Demand

[Text and concept of UNCITRAL draft Article 15 are unacceptable for standbys. There is no parallel under standby law and practice, and it will be necessary to reflect this distinction in the UNCITRAL draft should it be deemed necessary for guarantees. Should notice be required as a result of considerations between the beneficiary and the applicant, there is available in standby letter of credit practice a documentary method by which this can be achieved in a manner fair to all parties by means of an express provision in th letter of credit requiring a documentary method of giving such notification by the benficiary.]

Article 16. Examination of Demand

(1) The examination of documents shall be conducted in accordance with international standard banking practice to ascertain their facial compliance with the terms and conditions of the credit.

(2) Unless otherwise stipulated in the credit or by reference to international standard banking practice, the issuer or confirmer shall have a reasonable time, but not more than [seven] business days, following the day of presentation in which to examine the documents and to decide whether or not to honor. [N1]

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1. This draft Article is based on UNCITRAL draft Article 16 Variants A and Z and the treatment of these topics in draft UCP 500 Articles 13 and 14.

Article 17. Honor or Rejection of Demand

(1) The issuer or confirmer shall honor the credit unless:

(a) the standby credit was not issued or was terminated prior to such demand; [N1] or

(b) the demand does not meet the requirements referred to in Article 14; or

(c) the demand is improper according to Article 19.

(2) The issuer or confirmer may honor despite an assertion by the applicant that the demand is improper according to Article 19 provided that the issuer or confirmer acts in good faith. [N2]

(3) Unless otherwise stipulated in the credit, upon a decision to dishonor, the issuer or confirmer shall promptly, in accordance with international standard banking practice, give notice of dishonor listing all discrepancies and account for the documents. [N3]

(4) If the issuer or confirmer fails to comply with the provisions of Article 16 or paragraph (3) of this article in accordance with international standard banking practice, it shall be precluded from claiming that the documents are not in conformity with the terms and conditions of the credit. [N4]

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1. The references in the UNCITRAL draft to categories such as "Non-existent, invalid, or unenforceable" are not commonly used with respect to letters of credit and, consequently, are omitted in favor of the categories "issued" (or "established") or "terminated".

2. The UNCITRAL draft Variant B is included because it reflects an important principle of letter of credit practice under which the issuer is not required to dishonor based upon allegations of fraud as long as it can honor in good faith. The balance of UNCITRAL draft Article 17(2) is omitted because it runs contrary to standby practice under which honor occurs upon a decision by the issuer or confirmer that conforming documents have been presented unless the issuer or confirmer have actual knowledge of fraud or are enjoined from honoring.

3. Because standbys are letters of credit, the notice rules applicable to letters of credit apply to them. The language in the UNCITRAL draft Article 17(3) does not make clear the absolute and binding character of the requirement to give reasons and hold the documents at the disposal of the presenter. Therefore, reference is made to international standard banking practice, which is currently embodied in UCP 500 Article 14.

4. The bracketed language of UNCITRAL draft Article 17 (4) is included without brackets and expanded to indicate that this provision is not optional under standby practice which reflects letter of credit practice in adopting a rule of preclusion where there has been a failure to give notice without regard to whether or not the defect was curable.

Article 18. Request for Extension or Payment/Honor

[There is no law or pradtice for beneficiary demands or requests that a standby be extended or be paid other than the law and practice applied to demands for honor and to requests for amendment. the law should discourage beneficiary "extend or pay" demands on the issuer that are not provided for in the credit and therefore no provision for them should be made with regard to standbys.]

Article 19. Improper Demand

(1) A demand for honor is improper if made in bad faith or fraudulently or abusively, including fraud or forgery relating to the documents or fraud in the underlying transaction.

(2) The making of a demand is abusive and fraudulent where:

(a) the beneficiary [has no belief that the amount demanded is due] [knows or cannot be unaware that the amount demanded is not due] on the basis asserted in the demand and any supporting documents; or

(b) any supporting document is forged; or

(c) [the beneficiary exercises its right for a purpose other than that for which the standby letter of credit was given.] [the contingency against the consequences of which the standby letter of credit was designed to indemnify the beneficiary has undoubtedly not materialized or has clearly been brought about by a fundamental breach of the underlying transaction wilfully committed by the beneficiary.] [N1]

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1. This draft adopts the approach taken in UNCITRAL Draft Article 19 Variant C with some modifications designed to bring the language in line with that commonly used in letter of credit decisional law and to elaborate on the meaning of fraud in this context, i.e. in identifying hidden defects in the presentation that are so serious as to permit the issuer (or a court) to ignore the independence of the undertaking. Two alternate ways of expressing the intent are proposed in subarticles (2)(a) and (2)(c).

Article 20. Set-Off

[Variant B of UNCITRAL text is acceptable providing that set-off rights are extended to the confirmer or other person effecting payment of the proceeds. See Article 9).]

NOTE WITH REGARD TO ARTICLES 21 THROUGH 27:

With respect to UNCITRAL draft Articles 21 through 27, there is nothing peculiar to standby letter of credit law and practice that would warrant separate rules. It is noted, however, that the language in the text and titles of these draft UNCITRAL rules are derived chiefly from guarantee, not standby, law and practice. In order to accomodate standbys these names and titles would need to be changed or new names added.